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March 18, 2008

## **AGENDA ITEM 4-B**

### **TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE**

- I. SUBJECT:** Senate Bill 1123 (Wiggins)—As Introduced  
January 28, 2008
- Public Employee Benefits: Best Practices and  
Disclosure
- II. PROGRAM:** Legislation
- III. RECOMMENDATION:** Support
- Staff recommends that the Board support this  
legislation to improve pension and other post-  
employment benefit (OPEB) cost reporting and  
disclosure requirements, and to establish an  
expert panel to study and review actuarial  
policies and standards.

### **IV. ANALYSIS:**

SB 1123 requires state and local legislative bodies to review the impact of future annual costs associated with OPEB increases before their approval. These actuarial impact statements must be produced by an enrolled actuary and made public at a meeting of the legislative body at least two weeks prior to its adoption. It also requires an actuary to attend the meeting where the adoption of a new pension benefit or OPEB is considered, and prohibits the legislative body from approving new benefits or benefit increases by means of a consent calendar.

In addition, the bill creates a California Actuarial Advisory Panel (Panel) to provide information on pensions, OPEB's, best practices to the Legislature, the Governor, public retirement systems, public agencies, and interested parties, as well as actuarial model policies and pricing and disclosure and quality control standards for public sector actuaries.

## **Background**

### *Public Employee Post-Employment Benefits Commission*

Governor Arnold Schwarzenegger signed an Executive Order in December 2006, to create a 12-member panel to identify financial liabilities that California's public agencies and school systems face in paying pension and health care benefits for retiring employees.

On January 7, 2008, the Commission issued its comprehensive report containing 34 recommendations divided into 8 groups that addressed the unfunded pension and retiree health care liabilities for California state and local governments. The recommendations are a culmination of 10 months of work by the bipartisan commission, including nearly 100 hours of testimony received from policy experts, concerned citizens, governmental leaders, and public union representatives.

The recommendations are designed to help state and local leaders fulfill promises made to provide pensions and Other Post-Employment Benefits to the state's public workforce with sensible fiscal policies, allowing for long-term cost savings. The Commission is also calling for frequent and direct communication with employees and retirees about benefit availability and modifications. In addition, several recommendations were made to increase openness, transparency, and accountability throughout the benefits process.

### *Disclosure Requirements for Proposed Benefit Changes under CalPERS*

Contracting agencies seeking to change a CalPERS retirement benefit must adopt a resolution stating its intent to amend its CalPERS contract by majority vote of its governing body. Approval of a contract amendment cannot occur less than 20 days following the adoption of the resolution. If the employer is a city or county, the contract approval is in the form of an ordinance, which typically requires a first and second reading no less than 30 days apart (Government Code 20471). This statute also provides that approval of the contract can occur by passage of an ordinance approved by a majority of the registered voters of the public agency.

CalPERS retirement benefits for classified school employees are not collectively bargained and must be changed through state legislation. The public is able to comment on these benefit changes during the legislative process, and CalPERS is required to provide an actuarial cost analysis to the legislative fiscal committees before they can be acted upon. In regard to OPEB changes, the Education Code requires school districts to consider the impact of future annual costs, whereas, the Government Code does not.

Changes in CalPERS retirement benefits for state employees, may also be made by state legislation or they may be collectively bargained, however, these

agreements and addenda must also be reviewed and ratified by the Legislature. Again, CalPERS must provide an actuarial cost analysis to the legislative fiscal committees before the legislation can be acted upon.

#### *Actuarial Office Structure*

The Actuarial Office consists of 18 credentialed actuaries, all members of the Society of Actuaries, divided into three functional areas: (1) the Special Projects Team, (2) the Technology Services Team, and (3) the Valuation Services Team. The Valuation Services Team focuses on performing annual actuarial valuations and cost analysis of plan amendments, for the state, schools, and 1,500 contracting public agency plans. Over the last 7 years, CalPERS has performed between 900 and 2,000 actuarial valuations of proposed benefit increases each year. Of these valuations, between 200 and 500 of proposed benefit improvements were adopted each year. The 10 actuaries on the valuation services team also serve as consultants to the agencies to ensure that the employers understand the retirement costs associated with the respective benefit levels. CalPERS actuarial staff, within its current budget, provides consulting services to contracting agencies by telephone, on-site employer visits or, if requested, by attending meetings of a contracting agency's governing body. The actuarial office does not charge contracting agencies for on-site consulting services.

#### *Adoption of Actuarial Assumptions and Methods*

In California, retirement system boards were given constitutional authority by Proposition 162 to set actuarial methods and assumptions. The Chief Actuary recommends the actuarial assumptions and methods to the CalPERS Board in open public session. Significant changes require two public Board hearings for both a first and second reading. Interested employers are notified of Board action after both readings and have the opportunity to provide feedback to the Board.

Significant changes to actuarial assumptions and methods are also developed based on a thorough process that incorporates external review prior to adoption. For example, CalPERS' economic assumptions were developed by an external consulting actuary and were reviewed by CalPERS external auditing actuary prior to adoption. CalPERS' demographic assumptions were based on an experience study that was subject to an external audit which was presented to the CalPERS Board prior to adoption. In addition, recent changes to CalPERS' asset smoothing methodology were vetted with participating employers through numerous forums conducted over a six-month period.

### **Proposed Changes**

This bill:

- Adds the granting or changing of other post-retirement benefits such as health benefits, to existing reporting and disclosure requirements.
- Requires an actuary to attend the meeting where the adoption of a new benefit is considered, and
- Prohibits the legislative body from approving new benefits or benefit increases by means of a consent calendar.
- Creates a California Actuarial Advisory Panel to provide information on pensions, other post employment benefits, best practices to the Legislature, the Governor, public retirement systems, public agencies, and interested parties.
- Requires the Panel to review actuarial model policies, and pricing, disclosure and quality control standards for public sector actuaries.

### **Legislative History**

2008 AB 1844 (Hernandez) - Addresses recommendations from the Governor's Public Employee Post-Employment Benefits Commission (Commission). This bill would make it a crime to file a fraudulent claim for a retirement or disability benefit, and would provide CalPERS greater access to employment and investigatory information maintained by the Employment Development Department or workers' compensation insurers.

This bill also requires public agencies to report OPEB information to the State Controller, and requires the State Controller to develop a simple and inexpensive procedure to collect and report this information. In addition, before authorizing increases in public retirement plan benefits, this bill requires the actuary's statement of the actuarial impact upon future annual costs to include normal cost and any additional accrued liability, and that the agency chief executive officer attest in writing that he or she understands the current and future costs. *CalPERS' Position: Pending*

2007 Chapter (AB 554, Hernandez) - Provided all California public agencies access to the California Employers' Retiree Benefit Trust Fund (CERBT). The CERBT allows public agencies to invest money with CalPERS for the purpose of prefunding the future cost of their retiree health care benefits and OPEBs, but is currently only available to public agencies that contract with CalPERS for health benefits under the Public Employees' Medical and Hospital Care Act (PEMHCA). *CalPERS' Position: Sponsor*

- 2004 Chapter 52 (AB 2756, Daucher) - Revised various procedures for the fiscal oversight of school districts and the granting of emergency loans. *CalPERS' Position: None*
- 1991 Chapter 1213 (AB 1200, Eastin) - Among other things, established procedures for oversight of school district financial conditions, the reporting and adoption of employee benefit changes, and the granting of emergency loans. Authorized the appointment of a trustee or administrator to oversee the district and affect a fiscal recovery plan. As these emergency loans require a separate appropriation in legislation, most have also changed all or part of its provisions for the particular district receiving a loan. *CalPERS' Position: None*
- 1977 Chapter 928 (AB 727, McAlister) – Among other things, required each state and local agency which maintains a retirement plan to annually submit audited financial statements to the SCO and to triennially secure the services of an enrolled actuary, and require the SCO to annually compile and publish a report. *CalPERS' Position: Oppose*

## **Issues**

### **1) Arguments in Support**

According to the Chair, the Commission developed recommendations which are meant to facilitate compliance with the new reporting standards for Other Post-Employment Benefits, to ensure the fiscal integrity of California's pension systems, and to hold all public agencies to a standard of best practices in finance, disclosure, deferred compensation structure, and budget priorities.

### **2) Arguments in Opposition**

There is no known opposition at this time.

### **3) CalPERS Contracting Agencies May Have to Use Outside Actuarial Consultants**

The proposed statutory changes would require an actuary be present at the public meeting to explain the financial impact of benefit changes to the governing bodies when benefit improvements are under consideration. Due to staffing limitations and resources, there would be occasions when CalPERS would have to turn down requests by contracting agencies to be present at a public meeting where benefit improvements are considered. If CalPERS actuaries are unable to attend, the contracting agencies would be forced to rely on the services of an outside actuarial consulting firm and bear the cost.

4) Composition of Actuarial Advisory Panel

The introduced bill does not specify the composition and oversight of the proposed Panel. Based on its responsibilities, CalPERS staff recommends the Panel be comprised of credentialed actuaries that are members of one or more recognized professional actuarial organizations.

5) Technical Amendments Necessary

SB 1123 and its companion measure, AB 1844, provide the legislative solutions necessary to implement several of the Commission recommendations, and also amend the same Government Code section 7507. Unless each bill is amended to prevent its changes to section 7507 from being replaced by the provisions from the other measure, the reforms of the Commission will not be enacted.

6) Legislative Policy Standards

CalPERS' Legislative Policy Standards suggest a support position for proposals developed through a collaborative effort where the opinions of all relevant stakeholders are considered. This bill is a result of recommendations from a bipartisan commission and would increase transparency through enhanced disclosure requirements and an independent actuarial review process. Therefore, staff recommends the Board support SB 1123.

**V. STRATEGIC PLAN:**

This is not a specific product of the Annual or Strategic Plans, but is part of the regular and ongoing workload of the Office of Governmental Affairs.

**VI. RESULTS/COSTS:**

**Program Costs**

The proposed statutory changes would require an actuary be present at the public meeting to explain the financial impact of benefit changes to the governing bodies when benefit improvements are under consideration. If CalPERS actuarial staff is unable to attend this meeting on behalf of a contracting agency, the contracting agency would have to pay for the services of an outside private actuary.

**Administrative Costs**

This bill could increase administrative costs if there is a significant demand for CalPERS actuaries to attend public meetings when a contracting agency is considering a benefit improvement. Over the last 7 years, CalPERS has

performed between 900 and 2,000 actuarial valuations of proposed benefit increases each year. Of these valuations, between 200 and 500 of proposed benefit improvements are adopted each year. Currently, the actuarial office is budgeted to make approximately 120 contracting agency visits per year. During these visits, CalPERS actuarial staff tries to meet with more than one employer and on average can meet with two employers. It is estimated that the average cost for an on-site visit by CalPERS Actuaries is approximately \$300 per visit.

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